BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

---------In the Matter of--------	)	DOCKET NO. 2008-0274
	)	
PUBLIC UTILITIES COMMISSION	)	
	)	
Instituting a Proceeding to Investigate Implementing a Decoupling Mechanism for Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Limited.	)	

THE DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, AND TOURISM'S FINAL STATEMENT OF POSITION ON A DECOUPLING MECHANISM FOR HECO/HELCO/MECO

AND

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The Department of Business, Economic Development, and Tourism ("DBEDT"), by and through its Director ("Director") in his capacity as the Energy Resources Coordinator ("ERC"), and through the undersigned Deputy Attorney General, hereby submits to the Hawaii Public Utilities Commission ("Commission" or "PUC") its Final Statement of Position (FSOP) on the decoupling mechanism for the HECO Companies (HECO, HELCO, and MECO) pursuant to the PUC Order issued on January 21, 2009 approving the procedural schedule and issues.

A decoupling mechanism is an alternative form of utility ratemaking designed to eliminate or reduce the utility's inherent disincentives to promote energy efficiency, conservation, and other demand-side programs that impact the utility's kilowatt-hour sales, by making the utility's revenues (and earnings) independent from kilowatt-hour sales. The traditional ratemaking framework inherently provides financial incentives for a utility to increase rather than decrease its kilowatt-hour sales, since under this regulatory framework the utility revenues (and therefore, profits) are directly linked to the utility sales. Thus, any activity that lowers sales volume such as energy efficiency, conservation, and behind the meter customer-owned generators (i.e., net energy metering) will have a negative impact on the utility's bottom line. Conversely, any activity that increases sales will generally have a positive impact on the utility's earnings. A decoupling mechanism de-links or disassociates the utility's revenues (and profit) from the utility's sales, making the utility indifferent to changes to its sales volume.

The concept of decoupling is not new. Several other states have implemented (and terminated) decoupling mechanisms since the late 1980s and early 1990s to address the financial incentive issue when the requirement for the utilities to take an expanded role in designing, implementing, promoting, and delivering demand-side management programs first began. California, Idaho, New York, Vermont, Connecticut, Maryland, Washington, Oregon, Utah, North Carolina, and New Jersey currently have decoupling mechanisms for some or all of their gas and/or electric utilities. Maine adopted a revenue decoupling mechanism in 1991, referred to as Electric Revenue Adjustment Mechanism or "ERAM" and terminated it in 1993. Washington adopted a decoupling mechanism in 1990, referred to as Periodic Rate Adjustment Mechanism or PRAM, and terminated it four years later. Washington recently approved limited decoupling for gas companies. Oregon adopted a revenue-per-customer decoupling mechanism in 2002 and expanded it in 2006. There are several other states that are at different stages of adopting decoupling, including Connecticut and New Hampshire. Most of the current decoupling mechanisms in other states are based on the revenue-per-customer mechanism, and most have caps.

Background

On October 24, 2008, the PUC initiated the instant docket, Docket No. 2008-0274, to examine implementing a decoupling mechanism for Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO")(collectively, the "HECO Companies"), that would modify the traditional ratemaking framework for the HECO Companies by removing the link between the utilities' earnings and kilowatt-hour sales. The PUC's Order initiating the investigation cited the Energy Agreement ("Agreement") entered into between the State of Hawaii and the HECO Companies on October 20, 2008 under the auspices of the Hawaii Clean Energy Initiative ("HCEI"), and designated the HECO Companies and the Consumer Advocate as parties to the docket being signatories to the Agreement.

By Order issued on December 3, 2008, the PUC granted intervention to this proceeding to seven (7) parties including DBEDT[1]. On January 21, 2009, the PUC issued a Scoping Paper titled "Decoupling Utility Profits from Sales: Design Issues and Options for the Hawaii Public Utilities Commission" prepared by the National Regulatory Research Institute (NRRI). The PUC scoping paper discussed the driving forces for considering decoupling and identified issues, as well as four basic approaches to decoupling, including:

(1) A lost earnings tracker, similar to the lost margin cost recovery mechanism adopted by the PUC in the mid-1990s (when the HECO Companies were mandated to design and implement demand-side management programs in effect from 1996 to 2006);

(2) A total sales adjustment approach, which adjusts a utility earnings for any changes in total sales,

[1] The interveners in the docket include DBEDT; Hawaii Holdings LLC, doing business as First Wind Hawaii (First Wind); Haiku Design and Analysis (HDA); Hawaii Renewable Energy Alliance (HREA); Life of the Land (LOL); Hawaii Solar Energy Association (HSEA); and Blue Planet Foundation.

similar to the concept supported in principle by the Parties to the Energy Agreement;

(3) A sales per customer adjustment, similar to the total sales adjustment approach, except it is based on the average sales per customer; and

(4) A straight-fixed variable rate design, which as described in the scoping paper appears to be a cost-based rate design aligning the rates or charges to the utilities costs (i.e., recover fixed costs from fixed charges such as the customer charge or demand charge, and recover the variable costs from the variable charges such as the energy rates).

In addition to selection of a decoupling approach, the scoping paper also identified some implementation decisions, such as the calculation of lost revenues, lost earnings, and fixed costs; frequency of the decoupling adjustment; and allocation of the decoupling earnings adjustment.

On the same day, January 21, 2009, the PUC issued its Order approving with modification the parties' proposed Stipulated Procedural Order filed on December 26, 2008, which includes the procedural schedule and the issues to be addressed in the docket.

ISSUES

The issues in the docket as identified in the Procedural Order include the following:

(1) Whether the joint proposal or any separate proposals that are submitted by the HECO Companies, the Consumer Advocate or other parties are just and reasonable?

(2) Whether the decoupling mechanism(s) will result in accelerating the addition of new, clean energy resources in the HECO Companies' systems, while giving the HECO Companies an opportunity to achieve fair rates of return?

(3) What should be the scope of and elements to be included in the decoupling mechanism?

(4) How will decoupling impact the utilities, their customers, and the clean energy market?

(5) Which issues and details regarding the implementation of the decoupling mechanism(s), including the determination of any revenue target, should be taken up in the context of individual rate case proceedings of HECO, HELCO, and MECO?

(6) Whether any cost tracking indices proposed for use in estimating revenue adjustment calculations can be expected to determine just and reasonable revenue adjustments on an on-going basis, accounting for the differences between the revenue requirement amounts determined in each utility's last rate case, and:

a. The current cost of operating the utility;

b. Return on and return of ongoing capital investment; and

c. Any changes in State or federal tax rates.

(7) Whether any earnings monitoring/sharing, service quality provisions, or any other adjustments or considerations are appropriate to implement as part of the decoupling methodology in order to calculate ongoing revenue adjustments that are just and reasonable?

(8) Whether any provisions for administrative procedures (e.g., utility filings, decoupling tariffs, deferral accounting provisions, customer notice provisions, planned review/audit procedures and any appeal or hearing provisions) are appropriate, necessary and sufficient to ensure that post test year decoupling adjustments are fair and reasonable?

(9) How many years should the decoupling/attrition revenue mechanism remain in place for each of the utilities before the next rate cases are to be filed and under what conditions can the utility, the Commission or other parties initiate formal rate proceedings outside of such rate case intervals?

(10) What accounting and regulatory reporting provisions are necessary to implement any decoupling provisions in a manner that will ensure reasonable definition, isolation and recovery of the types of costs that are separately tracked and charged to customers through other cost recovery mechanisms, such as the

Renewable Energy Infrastructure Program/Clean Energy Initiative, Energy Cost Adjustment Clause, Purchased Power, Demand Side Management, and other surcharge mechanisms?

(11) Issues identified in the Commission's scoping paper in this docket (responded to in DBEDT's February 20, 2009 filing).

DBEDT's STATEMENT OF POSITION

The Energy Agreement entered into between the State and the HECO Companies on October 20, 2008 was cited by the PUC Order as the basis for initiating the instant docket.

The intent of the Energy Agreement was to remove the barriers to the HECO Companies aggressively pursuing and promoting demand-side programs (such as demand-response programs and energy efficiency programs), customer-owned and third-party-owned renewable energy systems and technologies, as well as to increase the use of renewable energy resources in the utility generation portfolio to help achieve the HCEI goal of transforming Hawaii to 70% renewable energy-based economy by 2030. DBEDT believes that the purpose of a decoupling mechanism is to remove the financial barriers faced by the HECO Companies in supporting and promoting the achievement of the HCEI goal.

DBEDT's positions on the aforementioned issues are as follows:

Issue #1:

The HECO Companies and the Consumer Advocate ("CA") separately filed their initial decoupling proposal on January 30, 2009, pursuant to the PUC Order initiating the docket. The separate proposals were very different in approach as discussed and summarized in DBEDT's opening Statement of Position filed on March 30, 2009.

On March 30, 2009, the HECO Companies and the CA filed a joint decoupling proposal and Statement of Position ("Joint Proposal"). This Joint Proposal adopted the CA's initial decoupling proposal with some modifications agreed to by the two parties. The Joint Proposal has two components: (1) a Revenue Balancing Account (RBA), which is essentially a true-up mechanism; and (2) a Revenue Adjustment Mechanism (RAM), which adjusts the HECO Companies' total revenue requirements independent of the utilities' kilowatt-hour sales between rate cases.

The Joint Proposal's proposed baseline is the interim revenue requirements approved by the PUC for each of the HECO Companies' test-year 2009 rate case proceedings. These revenue requirements will be determined under the traditional ratemaking framework, based on prudently incurred costs-to-serve plus a reasonable return on the HECO Companies' investment approved by the PUC. The proposed RBA component of the Joint Proposal will track the difference between the approved revenue requirements and the actual collected revenues, and such difference plus 6% interest will be added to or subtracted from the following post test-year RAM revenue requirements adjustment to determine the total revenue requirements for the post test-year period.

The Joint Proposal's proposed RAM revenue adjustment in between test-years is determined by: (1) escalating the HECO Companies' non-labor O&M expense (less fuel and purchased power expense and other costs that are or may be recovered through separate surcharges) based on the Blue Chip Economic Indicators Consensus forecast of the Gross Domestic Product Price Index (GDPPI); (2) escalating the HECO Companies' labor expense based on the effective contractual wage rate increase minus a 0.76% productivity offset; and (3) adjusting the recorded year-end net plant-in-service component of the ratebase based on the "baseline capital projects"; the "major capital projects"; calculated accumulated depreciation and deferred income tax; and contribution-in-aid-of construction (CIAC). The return on the ratebase adjustments is proposed to be the same as the PUC-approved return on ratebase in its interim decision on the HECO Companies' test-year 2009 rate cases.

The Joint Proposal also includes an earnings sharing mechanism as proposed in the CA's initial decoupling proposal, and is similar to the HECO proposal in Docket No. 99-0396. This earnings sharing mechanism will credit the ratepayers a certain percent of the HECO Companies' earnings that are achieved above their allowed rate of return.

Whether or not the Joint Proposal is just and reasonable will depend largely on: (1) the resulting rate impact as compared to what the ratepayers are or will be getting in return (most importantly, the HECO Companies' performance in achieving its commitments under the Energy Agreement to transition to a clean energy future); (2) whether the proposed mechanism will result in the utilities actually promoting and supporting increased energy efficiency, conservation, and customer-sited renewable systems rather than simply becoming indifferent to the sales impact of such activities and programs; (3) whether the impact of the proposed mechanism on the utilities' risks is reflected and taken into account in the determination of the reasonable return on investment in the HECO Companies' test-year 2009 rate cases (and beyond if the mechanism is allowed to continue); and (4) whether the proposed mechanism includes reasonable consumer protection.

DBEDT recognizes the difficulty of identifying and segregating the impact of the utility activities and programs that are related to achieving the HCEI goals from the effects of other factors, such as the economy or weather, on the utility's revenues and earnings. It is not, however, DBEDT's nor the HCEI's intent to implement a decoupling mechanism that simply insulates the utility from all the market risks and provides a guarantee for recovering 100% or more of its allowed return, at the same time shifting all the risks to the ratepayers, such as the effects of the current economic downturn.

In order to ensure that the decoupling mechanism proposed in the Joint Proposal is just and reasonable and effectively promotes the HECO Companies' performance in achieving its commitments under the Energy Agreement cited as the basis for this docket, DBEDT proposes that the decoupling mechanism proposed in the Joint Proposal be adjusted to reflect or include the following:

1) The HECO Companies' labor expense should be maintained at the approved level in the utilities' test-year 2009 interim revenue requirements in the determination of the RAM revenue requirements adjustment. Escalating the labor expense based on the current contractual wage rate increase as proposed in the Joint Proposal would make the utilities indifferent to labor costs increases as they are allowed and guaranteed to recover such costs

increases in the proposed decoupling. A guaranteed pass-through of labor costs increases could potentially eliminate the utilities' incentive to manage their labor costs through their contractual negotiations with the union.

2) The allowed RAM revenue requirements adjustment must be tied to the following performance metrics related to the achievement of the HECO Companies' commitments under the Energy Agreement: (1) new renewable power from net energy metered customers interconnected to the system during the year; (2) new renewable power purchased through FiTs during the year; (3) new renewable power purchased through the PV Host Program during the year; (4) the increase in other renewable power during the year; and (5) the number of new net energy metered customers interconnected in the system during the year.

DBEDT's response to CA-IR-3 filed on April 15, 2009, provided an illustration on how to tie or link the allowed RAM revenue requirements adjustment to the suggested performance metrics to encourage discussion amongst the parties during the Technical Workshop held April 20, 2009. Except for the HECO Companies, there appears to be general support among the parties to tie or link the decoupling mechanism to some performance metrics based on the commitments made in the Energy Agreement.

DBEDT believes that the amount of RAM revenue requirements that the HECO Companies will be allowed to recover must be linked to the aforementioned performance metrics as illustrated below for HECO:

	HAWAIIAN ELECTRIC COMPANY, INC. (HECO)			
Performance Measures	**Year 2010 Goals**	**Weights**	**Achieved Goals**	**Allowed RAM**
(A)	(B)	(C)	(D)	(E) = [(D/B) x (C)]
New Renewable Power from NEM (MW)	5.0	15.00%	4.0	12.00%
New Renewable Power Purchased through FiTs (MW)	6.5	25.00%	5.0	19.23%
New Renewable Power Purchased PV Host Program (MW)	2.0	25.00%	2.0	25.00%
Other New Renewable Power Purchased (MW)	30.0	25.00%	30.0	25.00%
Number on new NEM customers interconnected during the Year	300	10.00%	300	10.00%
Total		100.00%		91.23%
Calculated Total RAM Revenue Requirements Adjustment				$1,000,000
Total Allowed RAM				$912,308

Issue #2

DBEDT believes that the proposed decoupling mechanism, which includes an RBA and a RAM as proposed under the Joint Proposal, if linked to a set of performance metrics as proposed above, will likely result in accelerating the addition of new clean energy resources in the HECO Companies' systems, while providing the HECO Companies with the opportunity to earn fair rates of return.

Issue #3

In addition to the scope and elements included in the decoupling mechanism proposed under the Joint Proposal, DBEDT proposes that the PUC also address the following in implementing a just and reasonable decoupling mechanism:

1) The timing as to when the two elements (RBA and RAM) are adopted and implemented. The Joint Proposal proposes to begin the RBA component on the effective date of the PUC-approved interim revenue requirements for the test-year 2009 rate cases, and the RAM component will become effective beginning May 2010.

2) Consideration of modifying ECAC such that the performance incentives currently built-in to the ECAC calculation be modified or eliminated if decoupling is enacted. The basis for the Energy Agreement's support to implement a decoupling mechanism is to promote and accelerate the use and development of energy efficiency and renewable energy systems. Embedding a utility incentive in a cost recovery mechanism for fossil-based generation would continue to perpetuate the utility incentives to use fossil fuel-based generation, which runs counter to the intent of

the Hawaii Clean Energy Initiative that is supported by the Energy Agreement and cited as the basis of this docket.

Issue #4

The proposed decoupling mechanism will reduce the HECO Companies' risks which in turn should result in lower required return on investment, and therefore lower revenue requirements for the test-year 2009 rate cases (and beyond if decoupling is continued). The net impact on rates cannot be quantified or estimated until the test-year 2009 baseline revenue requirements are known and approved by the PUC. Additionally, the net cost and rate impact will also be impacted by the utilities' performance in meeting the performance metrics proposed by DBEDT. DBEDT believes that the cost and rate impact of decoupling should be compared with the attendant economic and environmental benefits of achieving the HCEI goals.

Issue #5

DBEDT suggests that the following issues and details should be taken up in the context of the HECO Companies' individual rate case proceedings:

1) assessment of any unintended consequences of the adopted decoupling mechanism, such as increasing rate volatility and uncertainty;
2) assessment of the use of a future test-year in rate case proceedings with the decoupling mechanism;

3) assessment of adopting caps in addition to linking to performance metrics if decoupling is re-authorized by the PUC to continue;
4) assessment of whether the decoupling finally adopted provides utility incentives that actually support and promote energy efficiency and conservation, especially since these programs are no longer administered by the HECO Companies, and whether the need for decoupling is lessened with the transfer of the programs to the Public Benefits Administrator;
5) assessment of whether the resulting adjustments to RAM revenue requirements are reasonable given the HECO Companies' actual incurred expenses reported in the test-year rate cases documentations;
6) assessment of the HECO Companies' operational efficiencies and cost management during the decoupling periods, as well as an assessment of any changes in the service quality as measured by certain service quality indices such as, but not limited to, the System Average Interruption Frequency Index (SAIF), and Customer Average Interruption Duration Index (CAIDI); and
7) assessment of the administration costs of the decoupling mechanism as compared to those of traditional rate cases.

Issue #6

DBEDT believes that this issue should also be addressed in the HECO Companies' individual rate case proceedings proposed to occur every two years for each utility under the Joint Proposal.

Issue #7

DBEDT strongly supports the inclusion of an earnings sharing mechanism as proposed by the CA's initial decoupling proposal, and adopted by the Joint Proposal.

Issue #8

DBEDT believes that it is prudent and appropriate to include administrative procedures in implementing a decoupling mechanism such as the filing of the decoupling tariffs complete with all supporting work papers showing the determination and calculation of the RBA and the RAM revenue requirements adjustments, and customer notification on pre-determined filing dates similar to the current procedure for the implementation of other rate changes or surcharges.

Issue #9

DBEDT supports the 2-year cycle proposed by the Joint Proposal as reasonable.

Issue #10

The filing and reporting requirements for the current ECAC and other surcharge mechanisms should continue during the decoupling years. The filing and reporting requirements for the REIS/CEIS should be as determined by the PUC.

Conclusion

In summary, DBEDT believes that the implementation of a decoupling mechanism is important in encouraging the HECO Companies to promote the increased use and development of energy efficiency and renewable energy to help achieve Hawaii's energy goals of energy independence and security with its attendant economic and environmental benefits. DBEDT is cognizant of the importance of recognizing the potential impacts of all the other incentives and regulatory mechanisms that are provided in the Energy Agreement, subject to PUC approval, on the HECO Companies' revenues and earnings, in designing a decoupling mechanism. DBEDT believes that any decoupling mechanism adopted and approved by the Commission should include consumer protection features as well as performance metrics such as suggested by DBEDT.

DATED: Honolulu, Hawaii, May 11, 2009.

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<u>Certificate of Service</u>

I hereby certify that I have served a copy of the Department of Business, Economic Development, and Tourism's Final Statement of Position on a Decoupling Mechanism for HECO, HELCO, and MECO, in Commission Docket Number 2008-0274, by electronic transmission on the date of signature to each of the parties listed below.

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